at the time of the tender transactions complained of. The suit is plainly not collusive in any respect. In verifying the substantive allegations on information and belief, Petitioner was entitled to rely upon her son-in-law, who had acted as her investment advisor, and upon the information he and her attorneys collected and relayed to her. Even if Petitioner's verification was in any respect insufficient, the courts below should have viewed the affidavits of the son-in-law and one of the attorneys as more than adequate to make up the deficiency. The courts below, in searching the record, should not have disregarded the additional affidavits. Actually, these affidavits go considerably beyond the confines of formal verification and constitute significant assurances of the substantial character of the allegations in the complaint.

II.

The Federal Securities Acts are designed to protect ignorant, uninformed, and gullible investors, and Congress intended that the private suit serve as a means of enforcement. Where a stockholder sues, his mental capacity, personal knowledge, and ability to explain the violations charged have nothing to do with the propriety of the action. There are also strong public policy considerations in favor of derivative suits in which stockholders bring to court corporate causes of action to check wrongdoing by officers and directors. Although such suits are attended by many obstacles and difficulties, they represent an essential remedy against abuses by insiders.

The Securities Acts and derivative suits as instruments for preventing corporate misconduct are especially important in light of the increasing number of uninformed, small stockholders, particularly women. The role such stockholders can play in checking abuses is of major significance in the area of corporate tender offers whereby corporations

buy in their own shares. Such practices by corporations have been growing, and there is not, at the present time, effective SEC supervision and policing. Combining the Federal Securities Acts and the derivative suit represents the best weapon available for checking abuses in the use of tender offers.

III.

The Federal Rules of Civil Procedure are to be construed liberally, and considerations of fundamental justice should not be sacrificed to technical interpretations of procedural rules. Rule 41 (b) has been used principally in aggravated cases involving failure to prosecute or disobedience to court orders. Here the use of the Rule to dismiss Petitioner's complaint without a hearing on the merits, in circumstances in which the validity and solidity of the complaint were expressly recognized, is virtually tantamount to imposing punishment on Petitioner for her supposed transgression. This Court has recognized that there are due process limitations on the power of courts to dismiss without affording the party dismissed an opportunity for a hearing on the merits. Here the facts are peculiarly within defendants' knowledge. Any expectation that the facts could be extracted from the Petitioner—in a suit such as this one—is unrealistic and unreasonable. Once the District Court was satisfied that the complaint was not a sham, it should have ordered the defendants to answer.

ARGUMENT.

I.

THE SPECIAL REQUIREMENTS OF RULE 23(b) WERE NOT DIRECTED TOWARD ABUSES BY STOCKHOLDERS IN SUING TO REDRESS CORPORATE WRONGDOING. RATHER, THEY WERE DEVISED TO PREVENT CORPORATE MANAGERS FROM MAKING USE OF PLIANT STOCKHOLDERS FOR THEIR OWN PURPOSES.

The District Court below evolved a novel theory of the meaning and purpose of the verification requirement of Rule 23(b), namely, that it was designed "to permit defendants to examine plaintiff concerning the factual basis upon which allegations of a complaint are made before defendants are required to proceed with the extremely costly and burdensome task of discovery [in] such complex cases" (R. 157). This being its purpose, "the person verifying the complaint must at least understand the nature of the charges in the complaint and have some knowledge concerning the factual basis for those charges" (R. 157).

The Court of Appeals, understandably, made no effort to sustain this view. Instead, it asserted that the Rule was intended, among other purposes, "to prohibit speculation in litigation and to protect the integrity of the invaluable instrument of a derivative suit" (R. 232). The Court of Appeals also stated that, while a derivative suit may have a "secondary value" to the stockholder-plaintiff in protecting the integrity of his investment, "the necessity for the contemporaneous protection of the corporation itself and of its officers and directors from ill-conceived, nuisance-value litigation is, at least, a consideration of equal value."

(R. 232-33.) The Court then stated its conclusion as to the purpose of the Rule's verification requirement (R. 235-36):

> The derivative suit is a unique vehicle of litigation. The holder of one share of stock who is disgruntled at some act of the corporation can, by this device, embroil the corporation and its officers and directors in protracted litigation. We think the verification requirement is designed to compel the plaintiff to begin such a suit with sufficient knowledge of facts and information to show by his verification that there is a substantial basis to support the complaint which he makes.

Thus both the District Court and the Court of Appeals—although finding different purposes in the Rule—agree in one significant respect: both courts are firmly of the opinion that a principal reason for Rule 23(b) and its verification requirement is the protection of the corporation (and, necessarily, its officers and directors) from unwarranted litigation.

It is submitted that, despite the dicta of some lower courts, the purpose is quite different: *it is to protect the federal courts from collusive devices engineered by corporate officers and directors to get into the federal courts and thereby to convert ordinary law actions into suits in equity.* This purpose rests not on a view of the probability of reckless and ill-founded suits by irresponsible stockholders but rather on the belief that corporate management will deliberately use compliant shareholders in order to accomplish corporate objectives. The thrust of the Rule is not against stockholders but against corporate managements.

A.

The Original Purpose of Rule 23(b) Was to Prevent Collusive Attempts to Obtain Jurisdiction in Equity in the Federal Courts Over Law Actions Where Valid Grounds for Federal Equitable Jurisdiction Did Not Exist.

As the Notes of the Advisory Committee on the Rules point out, Rule 23(b) was derived from old Equity Rules 94 and 27.[9] Equity Rule 94 was promulgated by the Supreme Court one week after its decision in *Hawes* v. *Oakland*, 104 U. S. 450 (1882). In Equity Rule 94, as in the *Hawes* case, the Court indicated its strong concern that there should not be an abuse of federal diversity jurisdiction. See *City of Quincy* v. *Steel*, 120 U. S. 241, 245 (1887). The purpose of the Rule was plainly not to impede or create barriers to stockholders' suits. To the contrary, in the *Hawes* decision this Court noted (at page 453):

> The exercise of this power in protecting the stockholder against the frauds of the governing body of directors or trustees, and in preventing their exercise, in the name of the corporation, of powers which are outside of their charters or articles of association, has been frequent, and is most beneficial, and is undisputed. These are *real contests*, however, between the stockholder and the corporation of which he is a member. (Emphasis added.)

What did plainly concern this Court was the widespread use of the doctrine of *Dodge* v. *Woolsey*, 50 U. S. (18 How.) 331 (1856), which opened the door to the federal courts in equity, via diversity of citizenship, in suits where stockholders charged that officers and directors of state cor-

9. The language of Rule 23(b) is very similar to the language of those Equity Rules. Equity Rule 27, promulgated in 1912, simply added to the end of the original Rule, Rule 94 (1882), the phrase "or the reasons for not making such effort." The text of Equity Rule 94 is to be found at 104 U. S. ix-x.

porations had failed to perform their duties or had violated corporate charters. As the Court noted in the *Hawes* case (104 U. S. 450, 452-53):

> This practice has grown until the corporations created by the laws of the States bring a large part of their controversies with their neighbors and fellow citizens into the courts of the United States for adjudication, instead of the state courts, which are their natural, their lawful and their appropriate forum. It is not difficult to see how this has come to pass. A corporation having such a controversy, which it is foreseen must end in litigation, and preferring for any reason whatever that this litigation shall take place in a Federal Court, in which it can neither sue its real antagonist nor be sued by it, has recourse to a holder of one of its shares, who is a citizen of another state.
>
> • • • • •
>
> If no non-resident stockholder exists, a transfer of a few shares is made to some citizen of another State, who then brings the suit.

To prevent such contrived lawsuits, the Court announced certain essential preliminaries (104 U. S. 450, 460-61):

> The efforts to induce such action as complainant desires on the part of the directors, and of the shareholders when that is necessary, and the cause of failure in these efforts, should be stated with particularity, and an allegation that complainant was a shareholder at the time of the transactions of which he complains, or that his shares have devolved on him since by operation of law, and that the suit is not a collusive one to confer on a court of the United States jurisdiction in a case of which it could otherwise have no cognizance, should be in the bill, which should be verified by affidavit.

The Rule, therefore, was designed to prevent collusion (a "friendly" derivative suit) by having non-resident stockholders appear as record plaintiffs. See *Groel* v. *United Electric Co.*, 132 Fed. 252 (C. C. N. J. 1904); Annotation,

"Stockholders' Actions—Federal Courts," 68 A. L. R. 2d 824, 843 (1957). Accordingly, the Rule required a specific averment against collusive action to confer federal jurisdiction. It also provided for an allegation that the plaintiff was a stockholder at the time of the transactions complained of; this, too, was aimed against transfers of stock to non-residents for collusive jurisdiction purposes. The requirement of demand for action on corporate management had a similar objective.

The requirement of verification, it seems clear, was intended still further to strengthen the assurances against collusive attempts to create federal jurisdiction. *Jacobson* v. *General Motors Corp.*, 22 F. Supp. 255, 257 (S. D. N. Y. 1938). Verification of the specific allegations called for by the Rule enhanced the likelihood that the plaintiff-stockholder was not acting at the behest of management, but rather was truly acting in a situation in which the corporation would not assert the corporate cause of action.

This Court was not seeking to impede "real contests" between stockholders and corporations or their officers which could come to the federal courts on grounds of diversity of citizenship. But it did want to stem the flood of "contrived contests" which were designed, not to permit the adjudication of real issues between the stockholders and the corporations or their officers, but to permit the corporations to misuse the federal courts.

A "real contest" was therefore one in which, but for the stockholder litigant, the cause of action—which was really the corporate cause of action—would not come to court at all. As the Court noted in *Delaware and Hudson* v. *Albany & Susquehanna R. Co.*, 213 U. S. 435, 446-47 (1909), where the corporate management is truly derelict and "the interests of stockholders put in peril . . . a case hence arises in which the right of protecting the corporation accrues to them." A contrived contest was one which, if Equity Rule

94 barred entrance to the federal courts, would find its way to a state court where it properly belonged, since the corporate managers wanted to bring it. There is nothing in the origin of the Rule even to suggest that this Court was seeking to make the bringing of a "real contest" against the corporation or its managers more difficult, or to protect those managers from suits by aggrieved stockholders. Cf. *Huntington* v. *Palmer*, 104 U. S. 483 (1882); *Doctor* v. *Harrington*, 196 U. S. 579 (1905); *Lindsley* v. *Natural Carbonic Gas Co.*, 162 Fed. 954, 957 (C. C. N. Y. 1908).

Since its inception, the Rule has picked up some not so clearly-related interpretations in the lower courts. Solicitude for management and the opprobrium attached to strike or nuisance suits have combined to produce pronouncements to the effect that the Rule is designed to protect corporations and their officers and directors from strike suits, *Pioche Mines Consolidated, Inc.* v. *Dolan*, 333 F. 2d 257 (C. A. 9th 1964), and to discourage speculation in litigation, *Gottesman* v. *General Motors Corp.*, 28 F. R. D. 325 (S. D. N. Y. 1961).[10] These views, of course, found expression in the opinion of the Court of Appeals below.

Whatever the occasion for these pronouncements, the results have been manifestly inconsistent with and unwarranted by the purpose of the Rule.[11] As one commentator

10. Other courts have even suggested that one of the Rule's purposes is to prevent champerty and maintenance. See *Bauer* v. *Servel, Inc.*, 168 F. Supp. 478, 481 (S. D. N. Y. 1958). Judge Roscoe Pound, however, was of the opinion that this latter consideration was not a reason for the Rule. *Home Fire Ins. Co.* v. *Barber*, 67 Neb. 644, 657-58; 93 N. W. 1024, 1029 (1903).

11. In light of the end sought to be achieved by promulgation of the Rule as disclosed in *Hawes* v. *Oakland* and subsequent cases in this Court, the application of the Rule to a derivative suit based upon a "federal question," and especially upon a question under the Federal Securities Acts, where the corporation, were it not in hostile hands, could itself properly bring the suit in a federal equity court, is questionable. The function of the Rule is not

noted (1 Foster, *Federal Practice*, § 145, p. 810, 6th ed. 1920):

> The original object of the rule was to prevent suits brought by stockholders, in collusion with the corporation, in Federal Courts, which otherwise would not have had jurisdiction thereof, and to remedy abuses in this respect, which had then become a common practice. It has been extended in the lower courts so as often to defeat the rights of shareholders and shield and encourage dishonesty by directors and officers of corporations.

B.

The Verification Requirement of Rule 23(b) Should Be Interpreted and Applied in Light of the Basic Reasons for the Rule.

The verification requirement of Rule 23(b), designed "to prevent collusive resort to the federal jurisdiction" (*Jacobson* v. *General Motors Corp.*, 22 F. Supp. 255, 257 (S. D. N. Y. 1938)), is not to be invoked in an arbitrary way "which would result in the emasculation of the equitable considerations that led to its enactment". *Cohen* v. *Industrial Finance Corp.*, 44 F. Supp. 491, 494 (S. D. N. Y. 1942); cf. *Hoover* v. *Allen*, 180 F. Supp. 263 (S. D. N. Y. 1960). Obviously, in a derivative suit, no rule of court can compel the plaintiff to verify substantive facts which are outside his grasp or understanding. Consequently, great latitude should be allowed in pleading, "since the facts are peculiarly within the defendants' knowledge and the sources of information are subject to their control." Hornstein, "Legal Controls for Intra-Corporate Abuse—Present and

involved. As far as we can ascertain, the pertinence of Rule 23(b) in such a suit has never been before this Court, but Petitioner need not go so far as to urge the point here. Compare *Lindsley* v. *National Carbonic Gas Co.*, 162 Fed. 954 (C. C. N. Y. 1908), and *Dottenheim* v. *Murchison*, 227 F. 2d 737 (C. A. 5th 1955), cert. den. 351 U. S. 919 (1956), with *Gottesman* v. *General Motors Corp.*, 28 F. R. D. 325 (S. D. N. Y. 1961).

Future", 41 Col. L. Rev. 405, 416-17 (1941). Rule 23(b) was never intended to impose a threshold standard of knowledge and understanding on the part of stockholder-plaintiffs as a condition to admission to the district courts.

Realistically, in a suit such as this one, personal knowledge by the plaintiff-stockholder is likely to be rare and unimportant. Insofar as the courts may require some assurance that the suit is not frivolous or baseless, the burden imposed on counsel by Rule 11 serves that purpose. *Murchison* v. *Kirby*, 27 F. R. D. 14 (S. D. N. Y. 1961); *Palmer* v. *Morris*, 316 F. 2d 649 (C. A. 5th 1963); cf. the remarks of Judge Clark quoted in *Freeman* v. *Kirby*, 27 F. R. D. 395, 399, n. 3 (S. D. N. Y. 1961).

Since the corporation is the real party in interest, and since the cause of action is that of the corporation, in a very real sense the plaintiff-stockholder's role is a nominal one. He is merely the person through whom the corporation's cause of action is brought to court in instances in which the corporation will not take the initiative. The stockholder's derivative suit "is an invention of equity to supply the want of an adequate remedy at law to redress breaches of fiduciary duty by corporate managers". *Koster* v. *Lumbermen's Mutual Casualty Co.*, 330 U. S. 518, 522 (1947). Although in some instances the stockholder may have a substantial personal interest, in others "he may also be a mere phantom plaintiff with interest enough to enable him to institute the action and little more." 330 U. S. 518, 525. So far as the stockholder's knowledge of the corporation's affairs is concerned, this Court observed in *Koster* (330 U. S. 518, 525):

> He may have taken some active part in the corporate affairs, or have personal knowledge of them, or have had dealings in course of protest and objection which make it requisite or at least expedient for him personally to be present at the trial. Or he may, like this

plaintiff, make no showing of any knowledge by which his presence would help to make whatever case can be made in behalf of the corporation.

Other courts have been inclined liberally to construe the verification requirement. See *Bosc* v. *39 Broadway, Inc.*, 80 F. Supp. 825 (S. D. N. Y. 1948); *Hoover* v. *Allen*, 180 F. Supp. 263 (S. D. N. Y. 1960). It seems clear that in doing so, these courts have been interpreting the Rule consistently with its true purposes. As this Court remarked at a relatively early point in the history of the Rule, it "is intended to have practical operation, and to have that it must, as to its requirements, be given such play as to fit the conditions of different cases." *Delaware and Hudson* v. *Albany & Susquehanna R. Co.*, 213 U. S. 435, 452 (1909).

The verification requirement cannot be viewed as a separate, distinct and unrelated requirement of the Rule; rather, it is a means of guaranteeing that the purposes of the Rule will be accomplished. The grammar of the Rule—both as originally written and as it now is embodied in Rule 23(b)—indicates that the entire complaint in a derivative suit is to be verified. In light of the origin and formation of the Rule, however, it seems evident that what this Court was most concerned about was *the veracity of the allegations indicative of the stockholder-plaintiff's bona fide status or standing to sue.*

Ordinarily, the plaintiff will know better than anyone else the matters required to be specifically averred by Rule 23(b), that is, the facts as to the plaintiff's ownership of stock and the period thereof, the plaintiff's residence, the absence of collusion with management, and efforts to secure corporate redress. Verification of these facts by the plaintiff furnishes the federal court with assurances as to matters required by the Rule.

No purpose of the Rule is served by requiring that the plaintiff must personally know, understand, or be able to

explain the basic facts or legal theory of the suit or the roles and activities of the individual defendants. By its terms, the Rule does not specify any degree of personal knowledge or understanding. Nor does the Rule bar a plaintiff verifying on information and belief from relying *wholly* on her advisors and legal counsel. The views of the courts below are therefore an unprecedented judicial gloss.

Even if one were to assume that those courts which regard the Rule as also aimed at speculation in litigation, at strike suits, and at champerty and maintenance are correct, it seems clear that a demonstration of the plaintiff-stockholder's knowledge and understanding is no protection against the supposed evils. A clever and articulate plaintiff, who can recite the theory and facts of a complicated complaint, may bring a worthless suit in bad faith. Conversely, a meritorious lawsuit may, as in Mrs. Surowitz' case, be filed by a stockholder of limited understanding. This is merely to say that the good faith character and assurance of merit in a suit cannot be determined by appraising the plaintiff-stockholder's analytical capacity, as the Court of Appeals seems to assume.

C.

Petitioner Truthfully Verified the Allegations Upon Which Her Standing to Sue Rests.

Mrs. Surowitz' verification asserts the truthfulness of the following italicized allegations (R. 64):

1. *She resides in and is a citizen of New York and is and has been a holder and owner of shares of $2.50 par value common stock of Hilton Hotels Corporation, which stock is registered and listed on and traded over the New York and Pacific Coast Stock Exchanges* (Paragraph 1 of each court, R. 2, 15, etc.). Mrs. Surowitz testified that

she resides at 1299 Ocean Avenue, Brooklyn, New York (R. 94) and that she acquired her Hotels Corporation shares "about 1957" (R. 96). The brokers' statements attached to Mr. Brilliant's affidavit, Exhibits A to I inclusive (R. 125-33), show Mrs. Surowitz' name, her Brooklyn address, and the purchase and holding by the brokers of 100 shares of Hotels Corporation stock from August 1, 1957 until October of 1963, at which time the shares were delivered. The December 17, 1962 offer sent by the Hotels Corporation to its shareholders, Exhibit B attached to the complaint, refers to the corporation's $2.50 par value stock and states that it is "listed on the New York and Pacific Coast Stock Exchanges" (R. 67). Mrs. Surowitz testified that she received this document and turned it over to her son-in-law (R. 109). At her deposition, Mrs. Surowitz was not asked any questions relating to her knowledge about the $2.50 par value of the stock or its being traded on the New York and Pacific Coast stock exchanges.

2. *Plaintiff brings the action on behalf of herself and the other approximately 12,000 holders of common stock to enforce rights of the Hotels Corporation* (Paragraph 1 of each count, R. 2, 15, etc.). Mrs. Surowitz was not asked any questions about this allegation.

3. *The action is not a collusive one to confer jurisdiction on the court of a cause of action over which it would otherwise not have jurisdiction* (Paragraph 1 of each count, R. 2, 15, etc.; Paragraph 5 of count VI, R. 35). With regard to this allegation, Mrs. Surowitz was asked the following question: "Can you give me the factual basis upon which the allegation is made under oath?" Her reply was: "I don't know. I can't tell" (R. 103-104). The question, of course, calls for an analysis of the facts leading to a legal conclusion; it is a question which only a lawyer, familiar with the collusive-suit problem as it relates to federal diversity jurisdiction, could reasonably answer.

More significantly, however, there hardly could be a "factual basis" for the assertion that a suit is not collusive *other than the absence of any facts which would suggest collusion.*

It is crystal clear that this suit is not collusive. As a matter of fact, with respect to the eight counts which plead federal causes of action under the Securities Act of 1933 and the Securities Exchange Act of 1934, the collusive-suit problem does not arise at all. But more, answers elicited from Mrs. Surowitz at her deposition indicate that her state of knowledge fully justified the conclusion, obviously framed by her attorneys, that the suit was not collusive. She testified that she did not personally know any of the individual defendants (R. 101), that she never had conversations with any of them, and that no such conversations had ever been reported to her (R. 100-01).

4. Finally, Mrs. Surowitz swore to the truthfulness of the following allegation: *"Plaintiff has heretofore protested to the defendant Corporation against the gross impropriety of the acts set forth above"* (Last sentence of paragraph 13 of counts I, II, V and VI; last sentence of paragraph 10 of counts III and IV; last sentence of paragraph 14 of counts VII, VIII, and XI; last sentence of paragraph 12 of counts IX and X (R. 14, 16, etc.).

Mrs. Surowitz was questioned twice about the factual basis for this allegation. In each case (R. 103, 104) she did not know or understand anything about it. Earlier in the deposition, however, Mrs. Surowitz testified that she signed a letter which Mr. Brilliant had brought to her; the letter was dated January 22, 1963 and was addressed to the Hotels Corporation (R. 97). The letter, Exhibit 1 to the deposition (R. 116), reads as follows:

> As a stockholder, I protest and challenge propriety of proposed plan to redeem company's common stock

and reduce its capitalization as set forth in your letters of December 17 and January 7.

I also challenge propriety of plan to purchase shares of Hilton Credit Corp. as set forth in your letter of January 7. Proposed actions serve no corporate interest and seem clearly detrimental to the welfare of the corporation and most of its stockholders.

/s/ Dora Surowitz,
1299 Ocean Avenue,
Brooklyn, N. Y.

This is the letter which Mr. Rockler prepared at Mr. Brilliant's request (R. 122, 137). Mr. Brilliant stated (R. 122): "I explained the letter to Mrs. Surowitz and told her that I had reviewed the matter with an attorney in Chicago. She signed the letter, and I mailed it to the corporation." Obviously the letter is the basis of the allegation that Petitioner heretofore (that is, prior to filing the complaint) protested to the Hotels Corporation. She knew about the letter, and she identified her signature; at the time Mr. Brilliant came to her with the letter Mrs. Surowitz testified that he told her "he would take care of it" (R. 110).

D.

Petitioner's Verification on Information and Belief of the Substantive Allegations Was Proper.

The Court of Appeals considered that the verification reflected "the mere formality of recklessly swearing to the truth of matters not known", and was therefore a nullity (R. 235).

The record establishes that Mrs. Surowitz relied implicitly on and trusted and believed in her son-in-law's information and advice. She purchased the very stock giving rise to the suit solely upon his recommendation. Throughout the pendency of the transactions in question and after

they had been carried through, the Petitioner consulted her son-in-law, who in turn investigated on his own and consulted legal counsel. Upon at least four occasions before bringing suit the Petitioner discussed the matters involved in the complaint: (1) when she received documents from the corporation, (2) when Mr. Brilliant brought the letter of protest to her, (3) when the dividend was passed, and (4) when the complaint was reviewed with her. In each instance, her son-in-law, after investigation, presented his views and recommendations. It is not at all clear why the Petitioner could not place faith in the honesty and wisdom of the advice she received both directly from Mr. Brilliant and indirectly through legal counsel who investigated the facts and prepared the complaint.

In any event, the verification on *information* and *belief* was not intended to and does not import personal *knowledge* and *understanding*. "Information", according to the *Oxford Universal Dictionary* (3rd ed., Oxford, 1955), refers to the "act of informing . . . the act of telling or *the fact of being told of something*" (Emphasis added). *Webster's Third New International Dictionary* defines it as "something received or obtained through informing." "Belief", says *Webster's*, is a "state or habit of mind in which trust, confidence or reliance is placed in some person or thing: faith." "Information" implies a *lack* of knowledge. See *State* v. *Simpson*, 136 Mo. App. 664, 667; 118 S. W. 1187, 1188 (1909). And "between mere belief and knowledge there is a wide difference." *Iron Silver Mining Co.* v. *Reynolds*, 124 U. S. 374, 384 (1888).

The description of corporate and financial manipulations set forth in the complaint was not prepared by Mrs. Surowitz; she did not personally ascertain the facts; nor are these kinds of transactions within her experience. It by no means follows that she was not informed and did not

believe what she was told by her son-in-law two and one-half months before the deposition.

No other court decision supports the kind of findings made here and the conclusions drawn therefrom. The case of *Murchison* v. *Kirby*, 27 F. R. D. 14 (S. D. N. Y. 1961), squarely repudiates both. The views in the *Murchison* opinion have been cited and quoted with approval in *Palmer* v. *Morris*, 316 F. 2d 649 (C. A. 5th 1963), where the Court of Appeals considered the requirements of a Rule 23(b) verification.

In other instances where verifications have been under attack, the courts have sustained the propriety of basing a verification on information and belief without personal knowledge. See *Manson* v. *Inge*, 13 F. 2d 567 (C. A. 4th 1926); *In re Thomas*, 211 F. Supp. 187 (D. C. Colo. 1962). As one Court of Appeals has observed, "knowledge in most affairs in life comes to us from information communicated to us by others." *In re Eastern Supply Co.*, 267 F. 2d 776, 778 (C. A. 3rd 1959). Also, "petitioner was not required to allege a fact . . . of his own knowledge, when it was hardly possible that he should know such fact." *In re Haskell*, 73 F. 2d 879, 880 (C. A. 7th 1934). To "require the specifications to be verified positively or on personal knowledge would place an undue burden" on the verifier where the facts lie particularly in the personal knowledge of the defendants. *Manson* v. *Inge*, 13 F. 2d 567, 569 (C. A. 4th 1920). Accordingly, verification may be properly made as to facts "derived from information which *the affiant* deems reliable". *In re Eastern Supply Co.*, 170 F. Supp. 246, 250 (W. D. Pa. 1959), aff'd 267 F. 2d 776 (C. A. 3d 1959) (Emphasis added).

E.

In Any Event, the Affidavits of Rockler and Brilliant Attested to the Truth and Accuracy of the Complaint and Could Not Be Ignored on the Motion to Dismiss.

In his sworn affidavit, Petitioner's counsel described his investigations and the obtaining of information from the SEC and from counsel for the defendants. This affidavit concluded: "To the knowledge of affiant, the allegations specified in the verification to be true and correct were and are true and correct." Further, "Affiant states that as a result of his investigations he believes the complaint in this action to be firmly grounded in fact and law. He fully expects that a trial of this matter will establish the merits of the plaintiff's position on behalf of herself and all other stockholders and the substantial truth and soundness of the allegations of fact set forth in the complaint." (R. 142-143.)

In his sworn affidavit, the Petitioner's son-in-law and advisor described the circumstances of his investigation into the challenged transactions. He concluded by stating that he told Petitioner that "the charges in the complaint reflected the investigations and study of Mr. Rockler and myself and that, in my opinion, the charges of wrongdoing were soundly based." (R. 124.)

These declarations under oath are plainly equivalent to additional verifications. They include not only the basic elements of verification, but go further in setting forth at length the bases and sources of the facts alleged in the complaint. Cf. *Bosc* v. *39 Broadway, Inc.*, 80 F. Supp. 825 (S. D. N. Y. 1948); *Brown* v. *Bernstein*, 49 F. Supp. 497, 499 (M. D. Pa. 1943).

If the affidavits in effect constitute verifications, they do not lose that character because they are entitled "Affi-

davits". Cf. *Brown* v. *Bernstein*, 49 F. Supp. 497, 499 (M. D. Pa. 1943). Since these affidavits were properly before the District Court in response to defendants' motion, it would have made little sense to file later an independent motion to submit them in order to relabel them "Verifications" (Cf. R. 238).

Where a trial court permits the introduction of materials outside the pleadings, "the inference to be drawn from the underlying facts contained in such materials must be viewed in the light most favorable to the party opposing the motion." *United States* v. *Diebold*, 369 U. S. 654, 655 (1962). Thus, where a defect in pleading federal jurisdiction was charged, this Court held that the defect was cured elsewhere in the record, *Sun Printing & Publishing Association* v. *Edwards*, 194 U. S. 377, 382 (1904):

> The whole record, however, may be looked to, for the purpose of curing a defective averment of citizenship, where jurisdiction in a Federal court is asserted to depend upon diversity of citizenship, and if the requisite citizenship is anywhere expressly averred in the record, or facts are therein stated which, in legal intendment, constitute such allegation, that is sufficient.

The issue is not one of labels—"verifications" vs. "affidavits"—but one of dismissing a case, without regard to the merits or any hearing on the merits, because of an alleged lack of sworn assurances. Therefore, even if contrary to the Petitioner's argument throughout, the Court of Appeals was entitled to treat Petitioner's verification as a nullity, complete disregard of the other statements under oath in the record, attesting to the truth of the complaint on the basis of investigation, research, information, and understanding, remains inexplicable and, in the circumstances, patently erroneous. Cf. *Lau Ah Yew* v. *Dulles*, 236 F. 2d 415 (C. A. 9th 1956).

II.

THERE ARE COMPELLING REASONS OF PUBLIC POLICY WHICH REQUIRE THAT STOCKHOLDER DERIVATIVE SUITS CHALLENGING CORPORATE TENDER OFFERS AS VIOLATIONS OF THE SECURITIES ACTS SHOULD BE ENCOURAGED, RATHER THAN HAMPERED OR RENDERED MORE DIFFICULT.

A.

The Policy of the Federal Securities Acts Is to Protect Investors, Particularly the Ignorant, the Uninformed, and the Gullible. One Important Means Provided by Congress for Their Protection Is the Private Suit.

The considerations which motivated the enactment of the Securities Act of 1933 and the Securities Exchange Act of 1934 are clear. Prior to the passage of these Acts, the regulation of the abstract and intricate business of trading in securities had been limited mainly to suits based on the law of fraud and deceit and the Blue Sky statutes enacted by state legislatures. The technicalities of the common law of fraud and deceit and the limitations of state jurisdiction made both sources of regulation ineffective. *United States* v. *Monjar,* 47 F. Supp. 421, 426 (D. C. Del. 1942), aff'd 147 F. 2d 916 (C. A. 3d 1944), cert. den. 325 U. S. 859 (1945); Note, *Implying Civil Remedies from Federal Regulatory Statutes,* 77 Harv. L. Rev. 285, 292 (1963). The Securities Act of 1933 and the Securities Exchange Act of 1934 were enacted to protect "those who did not know market conditions from the overreachings of those who do." *Charles Hughes & Co.* v. *Securities & Exchange Com'n,* 139 F. 2d 434, 437 (C. A. 2d 1943), cert. den. 321 U. S. 786 (1944).

In its Second Annual Report, the Securities and Exchange Commission summarized the purposes of the federal securities laws in the following terms (page 1):

> The purposes of the Securities Act of 1933, as outlined in the Report of the Commission on Banking and Currency are to prevent exploitation of the public by the sale of unsound . . . securities through misrepresentation; to place adequate and true information before the investor . . .
>
> The objectives sought in the passage of the Securities Exchange Act of 1934 were threefold, viz., to prevent the excessive use of credit to finance speculation in securities; to see to it that the market places in which securities are purchased and sold, such as the stock exchanges . . . are purged of the abuses which had crept into them; and to make available to the average investor honest and reliable information sufficiently complete to acquaint him with the current business conditions of the company, the securities of which he may desire to buy or sell.

The purpose of these laws was stated even more succinctly in earlier Congressional debate. "We want to protect the gullible investor, the investor who has been imposed upon . . ." (Representative Parker, 77 Cong. Rec. 2920, 73rd Cong., 1st Sess. (1933)). Another Congressman observed that the pending bill marked "a new recognition of responsibility on the part of the Government for the safety of investments made by millions of wage earners and small businessmen." (Representative Koppleman, 77 Cong. Rec. 2939, 73rd Cong., 1st Sess. (1933)).

Early court decisions established that it was no defense to a claimed violation of either of the Acts that the fraud was patent and could have been discovered by anyone of ordinary intelligence. ". . . The statutes . . . were enacted for the very purpose of protecting those who lacked business acumen. The need for such statutes is that 'the credulity of mankind remains yet unmeasured.'" *United States* v. *Monjar*, 47 F. Supp. 421, 425 (D. C. Del. 1942); *Securities & Exchange Com'n* v. *Time Trust Inc.*, 28 F. Supp. 34, 42-43 (N. D. Cal. 1939).

As further protection, injured persons were given a private right of action under the Acts. Fraud and chicanery in the securities field had been too pervasive to leave its regulation solely to the SEC with its limited resources of personnel and funds. Private action became an avowed means of legislative enforcement. See *J. I. Case Co.* v. *Borak*, 377 U. S. 426, 431-33 (1964); Note, *Implying Civil Remedies from Federal Regulatory Statutes*, 77 Harv. L. Rev. 285 (1963).

Consistent with this strong policy, the courts have brushed aside attempts to create impediments to actions by stockholders or other investors. Cf. *McClure* v. *Borne Chemical Co.*, 292 F. 2d 824 (C. A. 3d 1961), cert. den. 368 U. S. 939 (1961) (involving an attempt to require security for costs in an action by a stockholder under Section 10(b) of the 1934 Act); *Stella* v. *Kaiser*, 81 F. Supp. 807 (S. D. N. Y. 1948); *Deckert* v. *Independence Shares Corp.*, 311 U.S. 282 (1940). When it was not yet clear that a private suit could be brought under Section 10(b) of the 1934 Act, the Court of Appeals for the Ninth Circuit held that the far-reaching policy of the laws compelled recognition of the individual's right to sue as an enforcement technique. Civil liability would "deter fraudulent practices" by establishing the "right of defrauded sellers or buyers of securities to seek redress in damages in federal courts." *Fratt* v. *Robinson*, 203 F. 2d 627, 632 (C. A. 9th 1953).

It is clear, as a matter of statutory policy, that the *motives, purposes, character, nature, understanding and knowledge* of the plaintiff have nothing whatever to do with the propriety of an action. The statutes are designed to protect the public generally, and any aggrieved investor or buyer or seller of securities (who need not even be a stockholder) may seek redress. "The civil liabilities imposed by the Act are not only compensatory in nature but

also *in terrorem*. They have been set high to guarantee that the risk of their invocation will be effective in assuring that the 'truth about securities' will be told." Douglas and Bates, "The Federal Securities Act of 1933," 43 Yale L. J. 171, 173 (1933).

The *in terrorem* effect sought by the 1933 Act was directed at corporate management's conduct, not toward aggrieved stockholders. It would be surprising, therefore, if the *rules of procedure* applicable to enforcement of laws designed to protect the uninformed, gullible, and ignorant should be invoked to bar actions by such persons *because* they are uninformed, gullible, and ignorant in corporate affairs, and limited in their understanding of business and legal matters generally.

The decision of the Court of Appeals below represents a significant impairment of the right of a stockholder to bring to court a corporate cause of action against insiders. Although the decision below recognized that stockholders are proper instruments for bringing the cause to court, *it divided them into two classes:* stockholders who have the capacity to understand corporate transactions *and those who do not*. In effect, therefore, the Court of Appeals approved the dismissal of a meritorious cause of action simply because Petitioner, the plaintiff-stockholder, was too limited to understand what she was told about it by her advisors.

We urge to the contrary that an unknowledgeable stockholder is not unfit for the protection of the securities laws, whether suing individually or on behalf of the corporation.

B.

There Is an Equally Strong Public Policy in Favor of Stockholders' Derivative Suits.

The general state of affairs which has given rise to the necessity for permitting shareholders to sue on behalf of the corporation is stated succinctly in Sullivan, "The Federal Courts as an Effective Forum in Shareholders' Derivative Actions", 22 La. L. Rev. 580, 582 (1962):

> . . . With the creation in the corporation of a new professional management group to steer its economic course, the stockholders have made possible the situation where the dog may bite the hand that feeds it. The management group has the tremendous power of the purse which it may exercise, as well as inside knowledge of the operations and intentions of the corporation. This concentration of power constitutes a severe test of the honesty and integrity of the managing group, and it is to be deplored, but expected, that some will succumb to the forbidden fruit.

There are, however, real obstacles to the effectiveness of stockholders' derivative suits as a means of remedying abuses and reducing temptation. Quite apart from statutory restrictions (cf. Sullivan, "The Federal Courts as an Effective Forum in Shareholders' Derivative Actions", 22 La. L. Rev. 580 (1962)), there is the practical problem that many stockholders—probably the overwhelming majority—are reluctant to sue. Among other reasons, "they usually know that the evidence is almost exclusively in the control of those who are charged with delinquency; that those same individuals are likewise in control of the funds of the corporation and they apply them in defense of their acts, whether those acts are innocent or wrongful; that in seeking a remedy the stockholder will be met with every obstacle and procedural delay that the ingenuity of skilled

counsel can devise. . .'' *Dresdner* v. *Goldman Sachs Trading Corp.*, 240 App. Div. 242, 245; 269 N. Y. Supp. 360, 364-65 (1934).

A leading commentator, Hornstein, in "Legal Controls for Intra-Corporate Abuse—Present and Future", 41 Col. L. Rev. 405, 425 (1941), has stated that, "tested functionally, the stockholder's suit—while better than nothing—is of a low degree of efficacy." Nevertheless, the author recognizes that this remedy is the best of a poor lot available in this area. Cf. Hornstein, "New Aspects of Stockholders' Derivative Suits", 47 Col. L. Rev. 1, 31 (1947).

In concluding his article on "The Federal Courts as an Effective Forum in Shareholders' Derivative Actions, 22 La. L. Rev. 580, 603 (1962), Mr. Sullivan makes the following observations about the difficulties shareholder-plaintiffs face:

> Under the very best of conditions the stockholder's derivative action is a most difficult type of action. It suffers the infirmities of lack of information, substantial expense, difficulty of proof, and the unfortunate situation of facing the full majesty of the corporate power in support of the very individuals who have wronged the corporation. It is not a perfect remedy by any means, but it is the only effective remedy available to the stockholder who wishes to raise his voice against an abusive power by the management forces.
>
> The federal courts are an available forum for such suits and Congress has attempted to make the task of bringing derivative actions into the federal courts an easier one than is the lot of the average case. That this has not succeeded completely is due to unfortunate lapses in statutory drafting which has opened the door to strained and restrictive interpretations on the part of some of the courts.

Similar views have been stated by the courts. Thus, in *Cohen* v. *Beneficial Industrial Loan Corp.*, 337 U. S. 541, 548 (1949), this Court stated:

> This remedy born of stockholders' helplessness was long the chief regulator of corporate management and has afforded no small incentive to avoid at least grosser forms of betrayal of stockholders' interests. It is argued, and not without reason, that without it there would be little practical check on such abuses.

See also *McClure* v. *Borne Chemical Company*, 292 F. 2d 824, 827 (C. A. 3d 1961), cert. den., 368 U. S. 939 (1961); *Levitt* v. *Johnson*, 334 F. 2d 815 (C. A. 1st 1964); *Palmer* v. *Morris*, 316 F. 2d 649 (C. A. 5th 1963).

C.

The Significance of the Federal Securities Acts and of Derivative Suits as Essential Means for Protecting the Nation's Investors Is Highlighted by the Growing Number of Uninformed Small Shareholders.

The inherent technical and practical limitations on the bringing of derivative suits become even more significant in view of the fact that certain classes of shareholders, by virtue of educational and other natural limitations, have built-in infirmities which help to insulate corporate insiders against attack from the "outside". For example, according to *Shareownership U. S. A.*, the New York Stock Exchange 1965 Census of Shareowners, more than 50 per cent of the individual shareholders in this country are women and children. Indeed, the largest class of shareholders by occupation (34.7%) consists of housewives and non-employed women. While it is obvious that some women are knowledgeable in matters of corporate management, it would appear to be equally obvious that many of them, like the Petitioner in this case, are uninformed and ignorant in

such matters. From an educational standpoint, the New York Stock Exchange survey discloses that, excluding 1,280,000 shareholders who are minors, 3,106,000 shareholders (16.8% of all shareholders) have completed three years of high school or less. Moreover, nearly one-fourth (23.4%) of all individual shareowners are either under the age of 21 years (6.5%) or 65 years and older (16.9%). It is not far-fetched, especially in light of the proceedings below, to recognize that shareholders in these classifications would have a most difficult time withstanding the pressures and tactics of corporate counsel if they should undertake to bring derivative actions.

On the basis of the foregoing statistics, there are clearly large groups of American shareholders which would be blocked from attacking management irregularities if the rules regarding derivative actions are to be interpreted in such a manner as to require any measure of sophistication, and personal knowledge or understanding. Surely the right to sue to check corporate abuse should not depend on how much a shareholder *personally* knows or understands, without regard to his honest reliance on advisors and counsel.[12]

12. "It is probably no exaggeration to say that in many cases the transactions are so complicated that even skilled accountants and attorneys, informed that the corporation has been abused, find it impossible to unravel the intricacies and discover the nature of the wrong before suit is barred by the statute of limitations." Hornstein, "Legal Controls for Intra-Corporate Abuse—Present and Future", 41 Col. L. Rev. 405, 420 (1941).

D.

The Growing Practice of Corporate Tender Offers Can Only Be Policed by Stockholder Suits.

In recent years liquid funds in corporate treasuries have accumulated to such an extent that, under various circumstances, they represent an attractive, indeed lucrative, market for the sale of the corporation's own securities.[13] Tenders to the corporation itself are phenomena of increasing frequency. They apparently do not require registrations, prospectuses, and all other complications and costs of secondary offerings by shareholders to the public. They are available when, as in 1962, the stock market is depressed. In some cases, as here, "bail-outs" may be attempted without even seeking stockholder approval. In light of the decision below, they may be invulnerable to stockholders' redress if the stockholders cannot personally understand or explain what the insiders have done.

During the decade 1954 through 1963, 651 different companies listed on the New York Stock Exchange participated in reacquisitions of their own common shares.[14] These

13. Total corporate net current assets in billions of dollars have increased as follows:

1945	51.6
1955	103.0
1963	151.2

Corporate surpluses in billions of dollars have increased as follows:

1940	49.0
1950	129.4
1960	268.6

U. S. Bureau of the Census, *Statistical Abstract of the United States:* 1964, p. 493 (1964).

14. In 1963 alone, the amount spent by corporations listed on the New York Stock Exchange, 1.3 billion dollars, to repurchase their own securities, exceeded the amount of money raised in that year by such corporations from the sale of their own shares. Fleck, "Corporate Share Repurchasing: An Informed Discussion," 41 Harv. Bus. School Bull. 10 (1965).

companies represent 53 per cent of the total of approximately 1,200 corporations listed on the Exchange at the present time. In no single year of the ten studied did the total number of shares repurchased fall short of the amount reacquired during the preceding year. In terms of estimated dollar cost to repurchasing companies, there was an increase during the relevant decade from 274 million dollars in 1954 to 1,303 million dollars in 1963. Guthart, "More Companies are Buying Back Their Stock," 43 Harv. Bus. Rev. 40, 42-44 (March-April 1965).

Over the same period, numerous New York Stock Exchange companies engaged in general tender offers. All in all, approximately eight million shares were reacquired by listed companies in this fashion. Guthart, *op. cit.*, 53.

Where a corporation goes into the market to repurchase its own shares, without first communicating with shareholders, it *may* be subject to the anti-fraud provisions of Rule 10(b)—5, where the repurchase is for an improper purpose and such facts are not disclosed to the public. Where the corporation at the behest of management buys stock through a tender offer made generally to its stockholders, or redeems the stock of particular stockholders, it is clear that the company is subject to the anti-fraud provisions, since it has a duty to make adequate disclosure of any facts that would affect the investment judgment of the selling shareholders. See, e.g., *Kohler* v. *Kohler Company*, 319 F. 2d 634 (C. A. 7th, 1963); Kennedy, "Transactions by a Corporation In Its Own Shares," 19 Bus. Law 319 (1964). The problem is more troublesome and possible misdeeds are more serious when the corporation, as in this case, communicates directly with its shareholders for the purpose of soliciting the sale of their stock. One writer has recently expressed the belief that, under some circumstances, tender offers should be attended by "some sort of 'reverse prospectus'." Israels, "Corporate Purchase of

Its Own Shares—Are There New Overtones?" 50 Cornell L. Q. 620, 621 (1965).

At the present time, the SEC does not prescribe any standards for disclosure in communications to stockholders concerning tender offers. The SEC's Proxy Rules would, of course, compel relevant information, but if the corporation does not submit the matter to stockholders those Rules do not come into play. In the case now before this Court, the Hilton Hotels Corporation did not seek or obtain stockholders' approval of its tender offers. See Count VI of the complaint (R. 34-38).

In the light of the tremendous increase in corporate repurchases of shares and the use of tender plans, stockholders' challenges are a healthy response. Insofar as shareholders seek to combine the derivative suit and the anti-fraud provisions of the Federal Securities Acts, as Petitioner's complaint has done here, they are utilizing the best weapons available. Certainly, until the law requires a "reverse prospectus," there is no other way to prevent tender offers from becoming a major device whereby insiders may improperly use corporate funds.

The Court of Appeals below, however, appears to view the protection of corporate management against possible ill-founded suits as a mandate of the Federal Rules transcending strong federal policies in favor of stockholder actions. In this fashion it treated its own dubious interpretation of a procedural requirement as more important than major Congressional objectives for policing the securities markets.

III.

EVEN IF PETITIONER'S VERIFICATION WERE IMPROPER OR IN ANY SENSE FALSE, THAT CIRCUMSTANCE WOULD NOT WARRANT DISMISSAL.

In dismissing the cause, the District Court made no mention of Rule 41 (b) of the Federal Rules (R. 156-58). On appeal, however, the Court of Appeals stated that "The court below had inherent power to dismiss this complaint because of plaintiff's non-compliance with [Rule 23 (b)]", citing Rule 41 (b) (R. 238).

A strict and technical application of Rule 41 (b) in the circumstances presented in this case is contrary to the spirit and purpose of the Federal Rules of Civil Procedure. Rule 1 expressly states that the Rules "shall be construed to secure the just, speedy, and inexpensive determination of every action." As Professor Moore has noted, "liberality is the canon of construction." 2 Moore, *Federal Practice*, ¶ 1.13, p. 57. Moreover, in its grant of authority to establish the Federal Rules of Civil Procedure for the district courts, Congress was careful to provide that the Rules "shall not abridge, enlarge or modify any substantive right . . ." 28 U. S. C. Sec. 2072 (Rule-Making Statute). Recognizing the inherent limitation, this Court has declared that "[r]ules of practice and procedure are devised to promote the ends of justice, not to defeat them . . . Orderly rules of procedure do not require sacrifice of the rules of fundamental justice." *Hormel* v. *Helvering*, 312 U. S. 552, 557 (1941). Rules are not to be pushed so far as to bar on technical grounds a plaintiff from maintaining an action. *Washington Southern Nav. Co.* v. *Washington & Philadelphia Steamboat Co.*, 263 U. S. 629 (1924); *Perry* v. *Allen*, 239 F. 2d 107 (C. A. 5th 1956); *King* v. *Stuart Motor Co.*, 52 F. Supp. 727 (N. D. Ga. 1943).

Along the same lines, the Court of Appeals itself elsewhere disapproved of the dismissal of an action as a result of strict application of Rule 41, stating that the dismissal would produce injustice and that the Rule is not "a means of entrapment of the plaintiff." *Madden* v. *Perry*, 264 F. 2d 169, 175 (C. A. 7th 1959). One of the cases cited (R. 238) by the Court of Appeals in support of its view that Rule 41 (b) was properly invoked, *Meeker* v. *Rizley*, 324 F. 2d 269, 271-72 (C. A. 10th 1963), emphasizes that "the law favors the disposition of litigation on its merits . . . Dismissal is a harsh sanction and should be resorted to only in extreme cases."

These principles are meaningful in the present circumstances. Where the Petitioner filed a verification which is challenged as "false" solely because her subjective understanding is inadequate and her ability to recall and state on deposition what her son-in-law sought to explain to her is deficient, there is no failure of verification sufficient to warrant dismissal of the action. Especially is this true where the record indicates a careful examination of the information available to stockholders, and detailed substantiation of the allegations, by her legal counsel and her family-advisor son-in-law. The more limited the education and understanding of the Petitioner, the more it would seem she is entitled properly to rely on trusted agents whose competence in financial and legal matters may be greater. In *Murchison* v. *Kirby*, 27 F. R. D. 14 (S. D. N. Y. 1961), where a sophisticated and experienced stockholder, upon deposition, denied knowledge concerning allegations in his derivative suit, the court held that there was no basis for dismissal.

As a review of the many cases in which Rule 41 (b) has been invoked indicates, its primary use has been in instances involving failure to prosecute or disobedience to court orders. See, e.g., *Link* v. *Wabash R. Co.*, 370

U. S. 626 (1962); cf. 5 Moore, *Federal Practice* ¶ 41.12, pp. 1138-40. While Rule 41 (b), by its express terms, authorizes "an adjudication upon the merits," it has been generally recognized that only in aggravated situations should the Rule be so used. Cf. *O'Brien* v. *Sinatra*, 315 F. 2d 637 (C. A. 9th 1963); *Grunewald* v. *Missouri Pac. R. Co.*, 331 F. 2d 983 (C. A. 8th 1964); *Pierdon* v. *Chapman*, 169 F. 2d 909 (C. A. 3d 1948); *Syracuse Broadcasting Corp.* v. *Newhouse*, 271 F. 2d 910, 914 (C. A. 2d 1959). In *Package Machinery Co.* v. *Hayssen Mfg. Co.*, 266 F. 2d 56, 57 (C. A. 7th 1959), the Court of Appeals commented on the "almost inexhaustible patience of the district judge."

This Court has noted that "there are constitutional limitations upon the power of courts, even in aid of their own valid processes, to dismiss an action without affording a party the opportunity for a hearing on the merits of his cause". *Societe Internationale* v. *Rogers*, 357 U. S. 197, 209 (1958); *Hovey* v. *Elliott*, 167 U. S. 409 (1897); *Hammond Packing Co.* v. *Arkansas*, 212 U. S. 322 (1909). The distinction which runs through these cases—that summary disposition of a cause does not violate due process of law if the "essential basis" for the court's action is something more than "mere punishment", namely, a presumption as to bad faith and untruth to be drawn against the party who has failed to produce documents or to comply with some court order—indicates that the courts below, realistically, came very close to imposing punishment upon Mrs. Surowitz in the *Hovey* v. *Elliott* sense.

Far from suggesting that it was in any way drawing any inferences against the validity or truth of any of the allegations of the complaint, the Court of Appeals expressly conceded that "many of the material allegations of the complaint are obviously true and cannot be refuted" (R. 236). Moreover, it indicated that, were the contention advanced that the complaint was a sham pleading "in

the sense that it was without arguable foundation", the affidavits of Mr. Rockler and Mr. Brilliant would be controlling and would refute the merit of such a motion (R. 237-38). It also recognized that those affidavits revealed "that substantial and diligent investigation . . . preceded the filing of this complaint" (R. 237). Thus, insofar as the Court of Appeals indulged in any presumptions with respect to the solidity and truthfulness of the allegations in the complaint, it accepted them at face value. It is therefore difficult to characterize what the Court of Appeals approved other than as a species of punishment imposed on Petitioner for knowing so little when her deposition was taken. Needless to say, the meaning of this result will not be lost on other corporate defendants challenged by minority stockholders of limited comprehension.

One may well question whether the "punishment" fits the "crime". In *Leedom* v. *Int'l Union of Mine, Mill & Smelter Workers*, 352 U. S. 145 (1956), it was held that the NLRB had no authority to "decomply" a union even in a case where false swearing on a Section 9 (h) affidavit was properly found. Cf. *Farmer* v. *United Elec., Radio & Machine Workers*, 211 F. 2d 36, 39 (App. D. C. 1953).

In a case such as this, awareness of most of the matters is peculiarly within the defendants' knowledge. For defendants to expect to extract the facts from Petitioner personally, or for the courts below to insist that Petitioner's comprehension of certain facts was necessary to give the complaint "the breath of life" (R. 238), is, in a derivative suit complaining of violations of the Federal Securities Acts, completely unrealistic and unreasonable. Cf. *Lance, Inc.* v. *Ginsburg*, 32 F. R. D. 51 (E. D. Pa. 1962).

Instead of dismissing, the District Court, once satisfied that the complaint was not a sham and that counsel had complied with the requirements of Rule 11, should have required defendants to answer.

CONCLUSION.

For the foregoing reasons, Petitioner prays that the decision of the Court of Appeals be reversed and that the cause be remanded with instructions to reinstate the complaint and to require the defendants to answer.

Respectfully submitted,

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APPENDIX A.

STATUTORY PROVISIONS INVOLVED.

Securities Act of 1933 (15 U. S. C. Sec. 77a et seq.)

SEC. 12. Any person who—

* * * * *

(2) offers or sells a security (whether or not exempted by the provisions of section 3, other than paragraph (2) of subsection (a) thereof), by the use of any means or instruments of transportation or communication in interstate commerce or of the mails, by means of a prospectus or oral communication, which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements, in the light of the circumstances under which they were made, not misleading (the purchaser not knowing of such untruth or omission), and who shall not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of such untruth or omission, shall be liable to the person purchasing such security from him, who may sue either at law or in equity in any court of competent jurisdiction, to recover the consideration paid for such security with interest thereon, less the amount of any income received thereon, upon the tender of such security, or for damages if he no longer owns the security.

SEC. 17(a). It shall be unlawful for any person in the offer or sale of any securities by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, directly or indirectly—

(1) to employ any device, scheme, or artifice to defraud, or

(2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.

Securities Exchange Act of 1934 (15 U. S. C. Sec. 78a et seq.)

SEC. 9(a). It shall be unlawful for any person, directly or indirectly, by the use of the mails or any means or instrumentality of interstate commerce, or of any facility of any national securities exchange, or for any member of a national securities exchange—

* * * * *

(4) If a dealer or broker, or other person selling or offering for sale or purchasing or offering to purchase the security, to make, regarding any security registered on a national securities exchange, for the purpose of inducing the purchase or sale of such security, any statement which was at the time and in the light of the circumstances under which it was made, false or misleading with respect to any material fact, and which he knew or had reasonable ground to believe was so false or misleading.

* * * * *

(e) Any person who willfully participates in any act or transaction in violation of subsections (a), (b), or (c) of this section, shall be liable to any person who shall purchase or sell any security at a price which was affected by such act or transaction, and the person so injured may sue

in law or in equity in any court of competent jurisdiction to recover the damages sustained as a result of any such act or transaction. In any such suit the court may, in its discretion, require an undertaking for the payment of the costs of such suit, and assess reasonable costs, including reasonable attorneys' fees, against either party litigant. Every person who becomes liable to make any payment under this subsection may recover contribution as in cases of contract from any person who, if joined in the original suit, would have been liable to make the same payment. No action shall be maintained to enforce any liability created under this section, unless brought within one year after the discovery of the facts constituting the violation and within three years after such violation.

SEC. 10. It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—

* * * * *

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

APPENDIX B.

FEDERAL RULES OF CIVIL PROCEDURE INVOLVED.

Rule 11—Signing of Pleadings.

Every pleading of a party represented by an attorney shall be signed by at least one attorney of record in his individual name, whose address shall be stated. A party who is not represented by an attorney shall sign his pleading and state his address. Except when otherwise specifically provided by rule or statute, pleadings need not be verified or accompanied by affidavit. The rule in equity that the averments of an answer under oath must be overcome by the testimony of two witnesses or of one witness sustained by corroborating circumstances is abolished. The signature of an attorney constitutes a certificate by him that he has read the pleading; that to the best of his knowledge, information, and belief there is good ground to support it; and that it is not interposed for delay. If a pleading is not signed or is signed with intent to defeat the purpose of this rule, it may be stricken as sham and false and the action may proceed as though the pleading had not been served. For a wilful violation of this rule an attorney may be subjected to appropriate disciplinary action. Similar action may be taken if scandalous or indecent matter is inserted.

Rule 23—Class Actions.

(b) *Secondary Action by Shareholders.* In an action brought to enforce a secondary right on the part of one or more shareholders in an association, incorporated or unincorporated, because the association refuses to enforce

rights which may properly be asserted by it, the complaint shall be verified by oath and shall aver (1) that the plaintiff was a shareholder at the time of the transaction of which he complains or that his share thereafter devolved on him by operation of law and (2) that the action is not a collusive one to confer on a court of the United States jurisdiction of any action of which it would not otherwise have jurisdiction. The complaint shall also set forth with particularity the efforts of the plaintiff to secure from the managing directors or trustees and, if necessary, from the shareholders such action as he desires, and the reasons for his failure to obtain such action or the reasons for not making such effort.

Rule 41—Dismissal of Actions.

(b) *Involuntary Dismissal: Effect Thereof.* For failure of the plaintiff to prosecute or to comply with these rules or any order of court, a defendant may move for dismissal of an action or of any claim against him. After the plaintiff, in an action tried by the court without a jury, has completed the presentation of his evidence, the defendant, without waiving his right to offer evidence in the event the motion is not granted, may move for a dismissal on the ground that upon the facts and the law the plaintiff has shown no right to relief. The court as trier of the facts may then determine them and render judgment against the plaintiff or may decline to render any judgment until the close of all the evidence. If the court renders judgment on the merits against the plaintiff, the court shall make findings as provided in Rule 52(a). Unless the court in its order for dismissal otherwise specifies, a dismissal under this subdivision and any dismissal not provided for in this rule, other than a dismissal for lack of jurisdiction or for improper venue or for lack of an indispensable party, operates as an adjudication upon the merits.